

# THE DIMINISHED GIANT SYNDROME

## How Declinism Drives Trade Policy

Jagdish Bhagwati

**T**HE PERCEPTION, far exceeding the reality, of American decline is having subtly harmful consequences for U.S. international economic policy. The curse of declinism, manifest from the mid-1980s but contained by the Bush administration, was indulged to excess by Bill Clinton's campaign. Its political success in ending Republican presidential reign adds a lethal edge to the prospect that U.S. leadership will be sacrificed to the myopic and self-indulgent pursuit of "what's in it for us" economic policies in the world arena.

The American mood parallels Great Britain's at the end of the nineteenth century. Germany and the United States had emerged on the world economic scene as major players, threatening the end of the British Century. Today it is Japan that has emerged, threatening to open a Pacific Century. As was Great Britain at that time, America has been struck by a "diminished giant syndrome"—reinforced by the slippage in the growth of its living standards in the 1980s. This afflic-

tion has caused a loss of confidence in America's inherited postwar trade policies.

When the syndrome hit Great Britain unilateral free trade had been received doctrine, with Germany and the United States seen, correctly, as embracing tariffs to protect nascent industries. The ensuing debate was about renouncing British unilateralism, which had been practiced with a passion for nearly half a century. In the United States a parallel view has grown—with presumably immense influence in the Clinton administration—that America too has disarmed itself unilaterally in trade while others compete "unfairly" and that the time has come to shift from being patsies who turn the other cheek to becoming aggressive traders.

The British reality of asymmetrical trade barriers, which survived that nineteenth-century debate, is matched today only by America's perception of the same. This perception is grossly disproportionate to the reality, but it is driving Wash-

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ington toward trade policies that could well endanger the postwar trading system that it has so assiduously nurtured for more than forty years. It rests on a measure of self-serving exaggeration and distortion of facts, all a result of the panic and petulance that attend the diminished giant syndrome. Two examples should illustrate.

First, the belief is strong on Capitol Hill that, in the postwar period of nearly half a century, America gave away trade concessions and collected few in return. This was true in a few cases, as with developing countries and Europe right after World War II. But after the earliest rounds of multilateral negotiations, in every successive round America has sought and gained balanced concessions. Indeed, by most judgments the proposed "Dunkel Draft" agreement for the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) is heavily unbalanced in America's favor. Reciprocity, not unilateralism, has been America's motto in trade through nearly all its history. The contrary notion rests on a myth. But, held with conviction, it fuels the sense that America needs to switch from a multilateral exchange of concessions to unilateral demands for unrequited concessions by others. The earlier bargains were "unfair." Thus the new order should redress the imbalance that America's altruism spawned and which the aggrieved power can now ill afford.

Second, the notion that Japan is

"closed" is by now accepted among many as an article of faith. It continually leads to demands for managed trade in the shape of commitments by Tokyo for quantitative import targets and export concessions by Japanese industries. But these demands do not distinguish between "openness" and "penetrability." The Japanese market is open to manufactured imports, largely as a result of the trade liberalizations of the early 1980s. The U.S. market, on the other hand, is dominated by voluntary export restraints (on automobiles, among other items) and antidumping actions, from which Japan has abstained. But there remain many complaints of the difficulty of penetration resulting from Japanese institutions and practices that create witting and unwitting roadblocks to market access.

These cascading complaints are often a reflection of the fact that the Japanese economy has different institutional features that are a consequence of its history. Japan's success in escaping colonization and its policy of selectively importing foreign technology and ideas—and even of keeping foreigners at a distance within Japan—have prevented the extensive acculturation that other countries such as China and India went through over a century ago. Japan has been exposed to this process only since its postwar occupation. By now, however, the nation is changing rapidly. The new pace of acculturation is reflected in the prominent Japanese novelist

Junichiro Tanizaki's poignant essay, "In Praise of Shadows," which laments the passing of the old Japan. But acculturation works not merely through the conventional diffusion of American culture. It also operates through the extensive presence abroad of Japanese multinationals, and hence Japanese executives and their families.

The perception that the Japanese market is open and substantial has finally led to an increased willingness to undertake the added fixed costs necessary to enter it. The complaints about Japan's impenetrability are a clear sign that Japan is, in fact, being penetrated effectively. The unfamiliarity of the terrain is generating unreasonable demands that the Japanese landscape be remade in America's own image. The results of this penetration are reflected in the unprecedented rise in the late 1980s in the ratio of manufactured imports to GNP and as a share of total imports. Demands for widespread changes in Japanese institutions and for managed trade, quite aside from their potential for damage to a rules-based world trading regime, thus reflect a panic that is not justified by the unfolding situation.

Japan's chronic payments surplus is not a sign of its "closed" market or of predation by Japanese exporters in America's "open" market. Balance of payments surpluses and deficits reflect macroeconomic factors, not trade barriers. Occasionally, concerned congressional representatives will bow to this eco-

nomic logic. More often, however, they revert to what they think is surely "obvious." Thus many in Congress now seek to renew the Super 301 provision of the 1988 Omnibus Trade and Competitiveness Act, which would enable the Clinton administration to tag countries such as Japan as unfair traders—the criterion being that the competing nation accounts for more than 15 percent of the U.S. trade deficit. In her confirming testimony, even the president's chief economist, Laura D'Andrea Tyson, appeared to give a nod to this notion of a trade-barrier-caused payments deficit.

Of course, the Japanese trade surplus has grown even as its trade barriers have come down. Nor should one forget that, for a longer period than the "chronic" Japanese surplus, there existed the dreaded "dollar shortage" after World War II—and America would hardly accuse itself of being a closed or closing economy during those years of extensive trade liberalization. Nonetheless the Japanese surplus creates an inexorable sense that this "proves" that Japan is "closed" and, in turn, it drives demands for foolish changes in U.S. trade policy. The corrosive influence of these sentiments and misunderstandings is manifest in policy shifts that are already diluting the U.S. commitment to multilateralism, even as the president offers occasional support for the Uruguay Round.

# Unilateralism Hurts GATT

**S**UPPORT FOR aggressive unilateralism has grown. Threats of protectionist retaliation when others fail to meet either multilateral or bilateral treaty obligations is not the issue. It is only an issue when Washington uses its economic power to attempt to secure new concessions or changes in established trade practices that it unilaterally declares unfair or unacceptable. Such trade threats create the impression, now worldwide, that America believes in the law of the jungle rather than the rule of law—especially when these trade retaliations themselves are illegal under GATT.

The Clinton campaign unfortunately committed itself to reviving the lapsed Super 301 legislation in its manifesto, "Putting People First." This proposed legislation, alongside the attachment to the use of unilateralism, has added yet another objection to U.S. acceptance of the Dunkel Draft to settle the Uruguay Round: Washington now seeks to make the use of 301-type trade retaliation legal under GATT. This demand is most unlikely to be met since, as GATT chief Arthur Dunkel is supposed to have remarked, the best thing that the United States did for the GATT was to start down the 301 and Super 301 road, thus unifying an outraged and alarmed world behind the trading regime.

The problem with the embrace of aggressive unilateralism is that, in the end, other countries will not

suffer it gladly. The use of Super 301 in 1989 did not work against India and Brazil, which both refused to bow to U.S. demands. Japan responded tangentially and eventually settled with few concessions. Taiwan and South Korea made small concessions to avoid being named. The European Community (EC) was left unmolested, having made amply clear its intention not to be browbeaten.

The reaction in Japan to the prospect of reviving Super 301 is likely to be more spirited this time. The Matsushita Committee report and business groups have argued for Japan to arm itself with Super 301 legislation of its own; there has been similar talk in Europe. Undoubtedly some countries would take the United States to the GATT dispute settlement process if it became clear that, unlike the Bush administration, which tended to moderate the use of such actions, the Clinton administration was enthusiastic for them.

Widespread use of Super 301-style tools would create an environment in which countries, even if not engaged in trade wars, would be charging each other unilaterally with unfair trade practices, psyching each other out with tough talk and threatened action. The atmosphere would become conducive to a breakdown of the trust and confidence necessary to maintaining an orderly, predictable trading system—precisely the climate in which protectionism may flourish. An excellent illustration is provided by

the threatened use of the antidumping clause by Detroit's Big Three automakers. Once they thought that the Clinton administration favored aggressive action against foreign competition, they resorted to the "unfair trade" mechanism to secure their ends, as would be expected. But once foreign firms are unilaterally characterized as predatory or as being unfairly assisted by their own governments, or once foreign governments are accused of protecting their home turf—as indeed the Clinton people are given to doing—the outbreak of real trade wars looms that much larger.


### **Danger of Trade Blocs**

**D**ECLINIST sentiments may push the United States dangerously close to regionalism. Again there is an interesting parallel with Britain. In nineteenth-century Britain those who wanted to resort to (reciprocal) protection often also favored imperial preference, which would reserve British colonies for British goods, against Germany and America.

Today the enthusiasm for regional free trade areas is dressed up as a great free trade move. But it is evident that the main motivation is protectionist: Mexico becomes America's preferential market, with Japan and the EC at a disadvantage. Surely the relatively lukewarm enthusiasm among most American business groups for the Uruguay Round—as compared to passionate support for the North American

Free Trade Agreement—can be attributed in large part to the fact that any advantages America gains under GATT are equally doled out to rivals in the EC and Japan, while under NAFTA they flow asymmetrically to the United States.

As long as the talk of "head to head" confrontation with the EC and Japan drives U.S. policy—with its zero-sum implication that their success means America's failure—Washington will move toward preferential trading arrangements. As it pushes yet further into South America, Washington will certainly provoke an Asian trading bloc. Unless the United States stops NAFTA at Mexico and turns firmly toward GATT-based multilateralism, a likely consequence of its obsession with decline will be a fragmented world of four blocs: an augmented EC; NAFTA extending into the Americas; a Japan-centered Asian bloc; and a fourth "bloc" of marginalized nations such as those of South Asia and Africa whose recent shift toward outward trade will be frustrated by preferential trade arrangements. That would be a tragedy.

Pessimism about America's ability to lead in the teeth of its diffidence and declinism is only accentuated when one focuses on the prospects it faces in trade policy. Economists, whose science is soft rather than hard, are inordinately pleased when their predictions turn out. Nonetheless, in the present instance my failure would please me all the more. 

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